B

Lehman AR Reply Affidavit – Attachment B

state	99COST ($/mo.)	HCPM ($/mo.)	UNE ($/mo.)
AL	21.14	28.08	19.04
AR	27.03	24.94	13.09
AZ	23.79	18.17	21.98
CA	13.96	16.7	11.7
CO	25.01	19.8	20.65
CT	17.83	21.61	12.49
DC	7.64	13.28	10.81
DE	17.43	19.7	12.05
FL	21.87	18.84	17
GA	23.95	20.58	16.51
IA	15.45	20.57	20.15
ID	20.82	23.65	25.52
IL	14.12	17.09	9.53
IN	16.81	20.46	8.32
KS	22.72	21.11	13.3
KY	24.55	28.08	20
LA	22.96	24.43	20
MA	15.49	17.25	15.66
MD	16.12	18.47	14.5
ME	20.9	30	17.53
MI	16.44	20.23	10.15
MN	16.76	19.66	17.87
MO	19.82	21.18	15.19
MS	28.35	35.76	21.26
MT	24.69	27.73	27.41
NC	23.66	21.13	16.71
ND	18	22.52	19.75
NE	21.12	21.99	14.32
NH	20.4	24.08	17.99
NJ	17.19	17.33	16.17
NM	25.31	22.56	20.5
NV	19.71	24.59	19.83
NY	17.99	16.35	14.5
OH	14.7	18.66	7.01
OK	20.24	22.54	15.71
OR	22.66	19.51	15
PA	17.03	19.04	14.06
RI	17.21	18.78	17.53
SC	26.88	24.57	22.49
SD	19.65	23.8	21.09
TN	22.84	24.44	14.92
TX	21.65	18.55	14.15

UT	20.43	17.79	20
VA	19.03	19.42	13.597
VT	23.72	32.68	14.41
WA	19.58	18.25	11.33
WI	14.66	19.53	10.9
WV	25.66	31.71	24.58
WY	34.88	30.09	21.05

- Data is for the RBOC in each jurisdiction
- 99cost is embedded loop cost from Universal Service Fund Data: Neca Study Results, 1999 Report.
- HCPM is the monthly loop cost from the FCC HCPM results file, Jan. 2000 (unadjusted)
- UNE is the statewide average UNE rate from Gregg (2001 NRRI report), supplemented with data from industry contacts (for computing state averages where not reported in the Gregg report).

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Joint Application by SBC Communications	)	
Inc., Southwestern Bell Telephone Company,	)	
and Southwestern Bell Communications	)	CC Docket No. 01-194
Services, Inc. d/b/a Southwestern Bell Long	)	
Distance for Provision of In-Region,	)	
InterLATA Services in Arkansas and Missouri	)	

REPLY AFFIDAVIT OF DALE A. LUNDY

TABLE OF CONTENTS

ARKANSAS COSTING

I. INTRODUCTION AND QUALIFICATIONS

I, Dale A. Lundy, of lawful age, being duly sworn, depose and state:

1. My name is Dale A. Lundy. I am employed by SBC Communications Inc. ("SBC") as Director – Cost Analysis and Regulatory. My business address is One Bell Center, Room 38-Z-01, St. Louis, Missouri 63101.

2. As Director-Cost Analysis and Regulatory, I develop cost methods used to determine the costs incurred by Southwestern Bell Telephone Company ("SWBT"), among other SBC subsidiaries, for providing SWBT services. My responsibilities include supervision of the production of cost studies and their subsequent analysis.

II. PROFESSIONAL EXPERIENCE AND EDUCATIONAL BACKGROUND

3. I began working for SWBT in 1974. Initially, I was assigned to various jobs relating to Oklahoma Comptroller's Operations in Tulsa and Oklahoma City; my titles included Accounting Unit Supervisor and Accounting Manager. My responsibilities included supervision of employees responsible for day-to-day revenue accounting functions, such as service order processing and Automated Message Accounting (AMA) processing. In this capacity, I also oversaw systems support for accounting operations and network operations systems.

4. In June 1979, I was appointed Staff Manager-Cost Studies at SWBT's general headquarters in St. Louis. The subsequent positions I held included responsibility for development of cost study methodology, production of cost studies and regulatory

support. I was appointed to my present position as Director in 1985. In this capacity, I have supervised production of both embedded and incremental cost studies. I currently am responsible for developing policy, cost methodology, and cost study production for all of the 13 SBC states.

5. In 1973 I was awarded a Bachelor of Science degree in Mathematics from Oklahoma Christian College (now Oklahoma Christian University of Science and Arts). In addition, I have attended numerous SWBT-sponsored seminars on cost development, economic analysis, among other related areas. In July of 1991, I graduated from the Advanced Technology Innovation program at Carnegie Mellon University in Pittsburgh, Pennsylvania. I am also a member of the Society of Cost Estimating and Analysis (SCEA) and have earned the designations of Certified Cost Analyst (CCA) and Certified Cost Estimator/Analyst (CCEA).

6. I am the same Dale A. Lundy who previously filed an Affidavit in this proceeding on August 20, 2001.

III. PURPOSE OF AFFIDAVIT

7. The purpose of my reply affidavit is to respond to challenges to the costing portion of SWBT's Arkansas filing. I will respond to statements by Mr. Michael Baranowski (AT&T) and Mr. George Frentrup (WorldCom).

8. Specifically, I will show that their arguments amount to no more than groundless assertions that:

- The FCC was repeatedly wrong when it ruled in a number of decisions that one state may adopt the TELRIC-compliant rates of another state when the costs of the adopting state are higher than the costs of the target state.
- The Kansas Docket should be re-opened in an attempt to get even lower rates.

I will also show why the FCC should proceed with the adoption of Kansas rates in Arkansas.

IV. BACKGROUND OF ARKANSAS COSTS

9. The initial Arkansas affidavit of Mr. Tom Makarewicz demonstrated that Arkansas recurring costs were equal to or higher than Kansas costs. See Makarewicz Aff., App. A – AR, Tab 15 to SWBT's initial AR/MO Application. This is sufficient, in itself, to support Arkansas's adoption in whole of Kansas's TELRIC-compliant rates. However, as additional support in my initial affidavit, I demonstrate that Arkansas nonrecurring costs are overall higher than Kansas nonrecurring costs. In addition, I demonstrate that in Arkansas, the K2A's (Kansas 271 Agreement's) rates are more appropriate than the T2A's (Texas 271 Agreement's) rates. I explain why Kansas nonrecurring rates, as opposed to Texas nonrecurring rates, should be adopted in Arkansas.

10. The Arkansas Commission has chosen not to approve cost studies because of its interpretation of a state statute. However, as I explained in Paragraph 8 of my initial affidavit, the FCC in the Kansas/Oklahoma Order provided a means for Arkansas to

adopt TELRIC-based UNE rates approved in another state. See Lundy Aff., App. A – AR, Tab 14 to SWBT's initial AR/MO Application. The FCC stated in footnote 244:

> Indeed, in the appropriate circumstances, such as those described above, a state would be entitled to a presumption of compliance with TELRIC if it adopted New York or Texas rates in whole and could demonstrate that its costs were at or above the costs in that state whose rates it adopted.[1]

The FCC reiterated its position in the Verizon Massachusetts Order.[2]

11. Accordingly, Arkansas may adopt another state's FCC-approved, TELRIC-based rates, assuming two conditions are met:

- *Arkansas adopts the UNE rates of that state as a whole; and*
- *Arkansas UNE costs are at or above the costs of the state whose UNE rates are adopted.*

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[1] Memorandum Opinion and Order, Joint Application by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region, InterLATA Services in Kansas and Oklahoma, CC Docket No. 00-217, FCC 01-29, ¶ 82 n. 244 (rel. Jan. 22, 2001) ("Kansas/Oklahoma Order") ("We recognize that many states lack the extensive resources that were dedicated to this process by New York and Texas, as detailed in our orders in those states. . . . We encourage states with limited resources to take advantage of the efforts devoted by New York and Texas in establishing TELRIC-compliant prices, by relying where appropriate, on the existing work product of those states. Indeed, in the appropriate circumstances, such as those described above, a state would be entitled to a presumption of compliance with TELRIC if it adopted New York or Texas rates in whole and could demonstrate that its costs were at or above the costs in that state whose rates it adopted.")

[2] Memorandum Opinion and Order, Application of Verizon New England Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions) And Verizon Global Networks Inc., For Authorization To Provide In-Region, InterLATA Services in Massachusetts, CC Docket No. 01-9, FCC 01-130, ¶ 22 (rel. Apr. 16, 2001) ("Verizon Massachusetts Order").

12. The FCC's standards are logical.

- When Arkansas adopts the FCC-approved TELRIC-based Kansas rates, a set of TELRIC-based rates exists in Arkansas that satisfies the Telecommunications Act of 1996 ('96 Act).
- Because Arkansas costs are equal to or greater than the Kansas costs, adoption of Kansas' TELRIC-based rates in Arkansas results in rates that do not exceed TELRIC costs in Arkansas.

SWBT has adopted the K2A recurring and nonrecurring rates throughout the modified A2A. The FCC expressly concluded that the Kansas "recurring UNE rates fall within the reasonable range of TELRIC prices" and that the KCC had demonstrated "a consistent application of TELRIC principles in the setting of recurring prices."[2] The FCC also found the K2A's nonrecurring rates to be just and reasonable. With the voluntary reductions that SWBT offered to the nonrecurring charges in Kansas, the FCC concluded that they "eliminate[d] any remaining concerns about whether Kansas's nonrecurring rates are within the range of what a reasonable application of TELRIC principles would produce."[3] The Order commended the KCC "for its commitment to forward-looking pricing and the careful analyses it undertook in its ratemaking dockets."[4]

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[2] Kansas/Oklahoma Order, ¶ 55.

[3] Id., ¶ 60.

[4] Id.

13. In his initial Arkansas affidavit, Mr. Makarewicz demonstrated that Arkansas recurring costs for loops, transport and signaling ranged from 8 to 18% greater than Kansas, and line port and EO usage costs were essentially the same. In my initial affidavit, Attachment A, I show nonrecurring costs for key UNEs to demonstrate that Arkansas nonrecurring costs are overall greater than Kansas nonrecurring costs. *This provides the cost basis for the adoption of TELRIC-compliant Kansas rates in Arkansas.*

14. The fact that both the recurring and nonrecurring costs have been demonstrated to be overall greater in Arkansas than in Kansas, and that Arkansas has adopted the Kansas rates as a whole, means that the FCC's two criteria are satisfied, and that the Arkansas rates are entitled to a presumption of TELRIC compliance.

15. I also demonstrate in my initial affidavit that it was more appropriate for Arkansas to adopt Kansas rates than Texas rates. Kansas is more similar to Arkansas in network make-up, size and scope than is Texas. The zone groupings, and therefore the underlying cost characteristics of Arkansas, are much more similar to Kansas than to Texas.[5]

16. Attachment D to my initial affidavit shows that the Dallas and Houston exchanges in Texas each have more lines than the entire state of Arkansas or the entire state of

[5] See Lundy Aff., Att. C (Note: The number of lines has changed slightly from the comparison originally made in the state filing due to bringing all data to a current basis and a consistent data source. The changes would have no effect on the conclusions to be drawn.).

Kansas. These comparisons underscore the reasonableness of adopting Kansas rates for Arkansas rather than the Texas rates.

17. Dr. Lehman also points out in his reply affidavit that while the HCPM cannot solely be relied on to set the level of UNE prices, the HCPM does show by relative rankings that Arkansas costs are higher than Kansas costs, which in turn are higher than Texas costs. See Lehman Reply Aff. This once again supports Arkansas' adoption of Kansas rates.

18. Finally, I establish that Texas rates were inappropriate for Arkansas because Texas UNE loop nonrecurring rates omit the costs of travel and field cross-connect work performed by Installation and Maintenance (I&M) personnel, *i.e.*, the "trip charge" component for loops in Texas.

V. RESPONSE TO AT&T AND MICHAEL BARANOWSKI

19. AT&T makes the statement that SWBT's rates for non-recurring UNEs in Arkansas are not remotely TELRIC-compliant.[6] However, footnote 136 goes on to explain that AT&T's real concern is not TELRIC compliance, *i.e.*, whether the rates are cost based as required by the '96 Act, but instead *whether the UNE rates are sufficiently low to sustain UNE-based competition*. The '96 Act nowhere imposes such a test. Rather the requirement is that the rates be cost-based, which the FCC has deemed to be

[6] See AT&T Comments at 98. AT&T Comments, n. 136, suggests that the "public interest" requires the Commission to impose a requirement that UNE rates be set at the "lower" end of the TELRIC range.

within a range that a reasonable application of TELRIC would produce. To judge Arkansas' rates by any other standard is to re-write the '96 Act.

20. Mr. Baranowski argues that SWBT's Arkansas non-recurring charges ("NRCs") are higher than he believes is appropriate for three reasons:

- The Arkansas Public Service Commission adopted the Kansas NRCs without making an independent investigation of SWBT's cost studies.
- The rates adopted by Arkansas are the same rates that the Kansas Corporation Commission found to violate TELRIC principles.
- The NRCs are significantly higher than Texas, but should not be.

See AT&T's Baranowski Decl., ¶ 4. I will demonstrate why each of these statement is false.

21. Mr. Baranowski states that the Arkansas PSC did not perform an independent investigation of the rates or underlying costs, but merely adopted Kansas rates because SWBT's Kansas and Arkansas NRCs are similar. See id., ¶ 74. In fact, the Arkansas PSC did look at the evidence based on a comparison of the underlying costs between Kansas and Arkansas, and made special note of the fact that no party in the case refuted this evidence.

> "SWBT's witness Lundy testified that nonrecurring costs are generally higher in Arkansas than in Kansas. (T. 2368-2369). SWBT's witness Morrissey used the FCC's Hybrid Cost Proxy Model to demonstrate that recurring costs for unbundled network elements (UNEs) are higher in

Arkansas than in Kansas (T. 2394-2396). *This testimony was not disputed by the other parties*."[7] (Emphasis added).

The FCC further made note (1) that the proposed rates had been adopted by the Commission as TELRIC-compliant, and (2) that significant similarities existed between Arkansas and Kansas.

> "The record clearly reveals that costs in Arkansas are equal to or above Kansas costs. (T. 2337, 2391). The proposed UNE rates have also been approved by the FCC as being in compliance with the TELRIC methodology for use in the K2A. In addition, Arkansas and Kansas are geographically similar, have a common BOC and similar rate structures. Therefore, the Commission concludes that the UNE prices in the proposed A2A are within the parameters of the TELRIC methodology as applied."[8]

The Arkansas Commission concluded, on the basis of credible evidence, that Kansas rates were appropriate.

22. Mr. Baranowski also argues that the Kansas NRCs adopted by Arkansas are not TELRIC-compliant. See AT&T's Baranowski Decl., ¶ 74. The FCC's Kansas/Oklahoma Order, however, concluded otherwise:

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[7] Second Consultation Report of the Arkansas Public Service Commission to the Federal Communications Commission Pursuant to 47 USC Section 271(d)(2)(B), Application of Southwestern Bell Telephone Company for Authorization To Provide In-Region InterLATA Services Pursuant to Section 271 of the Telecommunications Act of 1996 and for the Approval of the Arkansas Interconnection Agreement, Docket No. 00-211-U, at 3 (Arkansas PSC May 21, 2001) (emphasis added) (Application, App. C – AR, Tab 86 to SWBT's initial AR/MO Application) ("Second Consultation Report").

[8] Second Consultation Report at 8.

> "As discussed below, we find that SWBT's rates for nonrecurring charges are within a reasonable range of what TELRIC might produce."[9]

The Commission went on to say:

> "Here, we find that basic TELRIC principles were followed, and we find no clear errors in substantial factual matters. We agree with the Kansas Commission that "it has appropriately exercised its flexibility to set prices within a range of TELRIC-based rates." Additionally, the Kansas Commission has demonstrated a commitment to setting rates pursuant to a TELRIC-based methodology. We note that the Kansas Commission modified various aspects of SWBT's cost model inputs once in 1999 and twice in 2000, and carefully considered and at times utilized alternative inputs from AT&T. We commend the Kansas Commission for its commitment to forward-looking pricing and the careful analyses it undertook in its ratemaking dockets. "[10]

Finally, after considering the voluntary rate reductions taken by SWBT, the FCC concluded:

> "We find that these additional voluntary reductions eliminate any remaining concerns about whether Kansas' nonrecurring rates are within the range of what a reasonable application of TELRIC principles would produce."[11]

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[9] Kansas/Oklahoma Order, ¶ 59.

[10] Id., ¶ 60.

[11] Id., ¶ 60.

Mr. Baranowski is simply attacking the FCC's Kansas/Oklahoma Order as being inadequate or deficient, which is completely without merit. Mr. Baranowski also attempts to re-argue what occurred before the Kansas Commission when it set nonrecurring charges. See AT&T's Baranowski Decl., ¶¶ 75-80. But it is unnecessary to re-open the Kansas proceedings to deal with these issues. Specifically, he argues that the NRCs are significantly above cost-based levels. See id., ¶ 81. However, the FCC has already found otherwise:

> We conclude that no commenters have raised specific allegations regarding "clear errors in factual findings on matters so substantial" that the end result falls outside the reasonable range of what TELRIC might produce. We disagree with commenters who assert that the Kansas Commission merely acted out of self-imposed pressure to quickly set permanent nonrecurring charges on reconsideration after it had approved SWBT's 271 application. The record indicates that the Kansas Commission labored for several years in setting cost-based nonrecurring charges.[12]

No useful purpose can be served by re-litigating this issue.

23. Mr. Baranowski argues that the rates are excessive when compared to Texas and that nonrecurring rates should not vary across states. See AT&T's Baranowski Decl., ¶¶ 82-83. He concludes: "Thus, the fact that SWBT's Kansas NRCs (and now Arkansas NRCs) significantly exceed those of Texas strongly suggests that SWBT's

[12] Id., ¶ 62.

Kansas and Arkansas NRCs are well outside the bounds of TELRIC compatibility." Id., ¶ 83.

24. This is simply another attack on the FCC's conclusion that Kansas NRCs are TELRIC-compliant and should be rejected.

VI. RESPONSE TO WORLDCOM AND CHRIS FRENTRUP

25. WorldCom makes the statement that "SBC presents no evidence that its Arkansas [sic] are consistent with the Commission's TELRIC principles." WorldCom Comments at 27. WorldCom's Mr. Frentrup says the same thing when he makes the statement that there is not any cost information provided in support of rates in Arkansas. See Worldcom's Frentrup Decl., ¶ 33. This is simply wrong. Attachment A to my initial Affidavit provides a great deal of cost information, as does the initial Affidavit of Mr. Makarewicz.

VII. CONCLUSION

26. The primary position taken by the parties in response to the Arkansas rates is simply that the Kansas Commission and the FCC did not do their jobs. As I discuss above, this assertion finds no support in the record.

This concludes my Affidavit.

I state under penalty of perjury that the foregoing is true and correct.
Executed on

Dale Lundy

STATE OF MISSOURI)
COUNTY OF JEFFERSON)

CYNTHIA J. HOUSLEY
Notary Public – Notary Seal
State of Missouri
County of Jefferson
My Commission Expires Feb 21, 2005

Subscribed and sworn to before me on this 28 day of September 2001.

Cynthia J. Housley
Notary Public

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OCT - 4 2001

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Application by SBC Communications	)	
Inc., Southwestern Bell Telephone Company,	)	
and Southwestern Bell Communications	)	CC Docket No. 01-194
Services,Inc. d/b/a Southwestern Bell Long	)	
Distance for Provision of In-Region, InterLATA	)	
Services in Arkansas and Missouri	)	

REPLY AFFIDAVIT OF THOMAS J. MAKAREWICZ

TABLE OF CONTENTS
COST AND PRICING ISSUES AFFIDAVIT

I, Thomas J. Makarewicz, being first duly sworn upon oath, do hereby depose and state as follows:

1. My name is Thomas J. Makarewicz. I am Acting Director – Cost Analysis at SBC Telecommunications Inc. My business address is One Bell Center, Room 38-Y-5, St. Louis, Missouri 63101. I am the same Thomas J. Makarewicz who filed an Initial Affidavit on August 20, 2001.

Purpose of the Affidavit

2. In this affidavit, I explain that an analysis of the Missouri and Kansas Commissions' treatment of SWBT's TELRIC studies is the only prescribed vehicle for evaluating TELRIC-compliance of UNE rates. SWBT's Missouri and Arkansas UNE prices are entirely compliant with TELRIC principles. Missouri UNE prices were set after extensive reviews and proceedings conducted by the Missouri Public Service Commission ("MPSC"). Arkansas UNE prices are similarly TELRIC compliant because they mirror Kansas rates which underwent intensive scrutiny and approval by the Kansas Corporation Commission ("KCC") and the FCC. Any application of the USF Model to identify proxy measures for TELRIC compliance must strictly be limited to a comparison of the relative difference in cost results among states.

3. I respond to the improper use of the FCC's Universal Service Fund ("USF") cost model contained in the affidavits of Z-Tel's George S. Ford, AT&T's Michael Lieberman and WorldCom's Chris Frentrup. These affiants disregard the FCC's admonitions concerning the limited role and proper use of the FCC's USF cost model. Moreover, Z-Tel and WorldCom completely disregard the thorough reviews of SBC's TELRIC studies undertaken by the Missouri

and Kansas[1] Commissions. Instead, these parties seek to use the USF Model as the only relevant litmus test for judging UNE rate levels. As the FCC repeatedly has stated, USF Model cost results cannot be used to determine whether prices have been set in accordance with TELRIC principles. Z-Tel, AT&T and WorldCom all overextend the FCC's imposed limitations on the use of USF Model cost results, drawing improper conclusions that undermine the required TELRIC principles to which only SBC's cost studies (and its attendant UNE rates) adhere. This faulty use of USF Model cost results by the intervening parties must be rejected.

<u>Z-Tel's Analysis Employing the USF Cost Model is Unfounded. SWBT's Approved TELRIC Studies Are the Appropriate Means of Determining TELRIC-Compliance of UNE Rates</u>

4. The very premise upon which Z-Tel relies for introducing cost results from the USF Model is plainly false. In his affidavit at ¶ 3, George S. Ford states that Z-Tel's analysis is "particularly applicable in the instant proceeding because the rates in neither Arkansas nor Missouri are fully based on a TELRIC cost study." Dr. Ford goes on to opine in ¶ 4 that "[b]ecause it cannot rely upon the results of a complete state commission cost proceeding," his self-appointed "TELRIC Test" is the only means the Commission can use to ensure TELRIC compliance.[2] This is an entirely faulty premise that invalidates Z-Tel's subsequent application of USF Model cost results. First and foremost, as I made clear in my Initial Affidavits, SBC conducted complete TELRIC studies to support all rates proposed for Missouri and Arkansas. In Missouri, the MPSC approved Missouri 271 Agreement ("M2A") rates after its Staff conducted an exhaustive review of SWBT's TELRIC studies in one docket, which culminated in final

[1] I intentionally refer to the KCC here because SWBT adopted Kansas rates in its Arkansas application.

[2] This position also is reiterated in Z-Tel's Comments which state "[I]t is important to note that, consistent with Commission precedent, SBC must pass the TELRIC Test – because the rates have not been the subject of a complete cost study," Comments of Z-Tel Communications, Inc., CC Docket No. 01-194, at 6.

approval of the M2A rates later.[3] *See also* Barbara Smith Reply Affidavit, filed concurrently herewith. This description is corroborated by the MPSC's Written Consultation filed in this proceeding:

> "Our Staff conducted an intensive 16-week review in Case No. TO-97-40 and we established prices in that case based on our Staff's recommendation. We determined those prices to comply with the total element long run incremental cost methodology (TELRIC)...In this application, Southwestern has proposed to further reduce in the M2A certain rates that we established in Case No. TO-97-40. We have approved an amendment to the M2A to lower these rates."[4]

5. SBC also conducted complete TELRIC studies for Arkansas, but, as I explained in my Initial Affidavits (¶ 5 of Missouri, ¶¶ 5-7 of Arkansas), the Arkansas PSC ruled that it did not have statutory authority to review SWBT's costs and rates *See* Makarewicz Aff. (App. A, Tab 15 to SWBT's initial AR/MO Application). Consequently, SWBT proceeded with TELRIC-compliant prices from Kansas because Arkansas facility costs are overall at least equal to or higher than Kansas costs, as demonstrated by cost results from the USF Model.[5] My cost comparison between Arkansas and Kansas relying on USF Model results satisfies the FCC's standard for adoption of TELRIC compliant rates by one state from another as articulated in both the Kansas/Oklahoma and the Massachusetts 271 Orders.[6] The TELRIC studies underlying the

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[3] Prices and costs were extensively reviewed in Case Nos. TO-97-40 and ultimately approved in TO-98-115.

[4] Written Consultation of the Missouri Public Service Commission, CC Docket No. 01-194, p. 9.

[5] This cost comparison appears in Table 1, ¶ 8, of the Makarewicz Initial Affidavit for Arkansas. Mr. Dale Lundy, in his affidavit establishes that Arkansas non-recurring costs overall are higher or equal to Kansas non-recurring costs. *See* Lundy Aff. (App. A, Tab 14 to SWBT's initial AR/MO Application).

[6] Memorandum Opinion and Order, Joint Application by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. for Provision of In-Region, InterLATA Services in Kansas and Oklahoma, CC Docket No. 00-217 (rel. 1/22/01), ¶82, n.244 ("Kansas/Oklahoma Order"); and Memorandum Opinion and Order, Application of Verizon New England Inc., Bell Atlantic Communications, NYNEX Long Distance Co. and Verizon Global Networks Inc. for Authorization to Provide In-Region, InterLATA Services in Massachusetts, CC Docket No. 01-9 (rel. 4/16/01), ¶22 ("Massachusetts Order").

Kansas rates underwent and passed a lengthy and complete cost investigation by the Kansas Corporation Commission ("KCC"). In fact, in the FCC's Kansas/Oklahoma 271 Order, the FCC concluded that the KCC fulfilled all regulatory requirements in carefully reviewing and approving SWBT's TELRIC studies:

> We conclude that Kansas' recurring UNE rates fall within the reasonable range of TELRIC prices. Furthermore, the Kansas Commission's orders show a consistent application of TELRIC principles in the setting of recurring prices. Because no commenter presents evidence of clear errors in substantial factual matters, and the Kansas Commission followed TELRIC principles, we conclude that these prices comply with our rules."[7]

The FCC further concluded that both the Kansas recurring and nonrecurring rates were TELRIC compliant.[8] Therefore, because the Arkansas rates are borrowed from Kansas, and the Kansas rates were clearly found to be TELRIC compliant, Dr. Ford's contention that Arkansas rates are not "fully based on a TELRIC cost study" is entirely untrue.

6. Rather than analyze whether there has been any "clear error" in the application of TELRIC rules in setting rates, Z-Tel seeks to introduce a mechanism that it labels a "TELRIC Test" as Z-Tel's panacea for gauging whether or not a state's UNE rates comply with TELRIC principles. (*See* Z-Tel Ex Parte presentation, filed 9/7/01). Z-Tel's use of the term "TELRIC Test" is a misnomer. It should accurately be labeled a "TELRIC-*Replacement* Test."

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[7] Kansas/Oklahoma Order, ¶ 55. The FCC goes on to commend the Kansas Commission "for its commitment to forward-looking pricing and the careful analysis it undertook in its ratemaking dockets," ¶ 60.

[8] *Id.*

7. Z-Tel proposes to validate any UNE rates as TELRIC compliant simply by deriving the percentage difference in rates between two states, and matching that rate differential with a "cost" differential relying solely on results from the USF Model. Dr. Ford, at ¶ 12 of his Declaration, indicates that the "TELRIC Test" "simply indicates that the ratio of UNE rates [between a 'subordinate' state and a 'reference' state] must be (approximately) equal to or less than the ratio of HCPM costs."[9] Further, Dr. Ford "selects" an appropriate reference state, labeled his "best practices" reference state.[10] In reality, this proposal is simply a means of picking and choosing states where particular UNE rates have been driven down the most. This "pick-and-choose" approach essentially indicts all but a single state. It presumes that, for example, the Missouri, Oklahoma and Kansas commissions did inferior jobs in their exhaustive reviews and multiple rulings on SWBT's TELRIC studies in those states (and, by extension, in Arkansas). Moreover, by selecting "reference states" that may have vastly different cost characteristics than the subordinate state, this "pick-and-choose" approach compromises the legitimate cost distinctions that only TELRIC studies, particular to each state, manifest.

8. Dr. Ford also seizes upon an extremely minor discrepancy in my limited cost comparison between Kansas and Arkansas presented in Table 1 of my initial Affidavit for Arkansas. As he explains in ¶¶ 37-38 of his declaration, Dr. Ford agrees with my analysis, but is troubled that the

[9] The USF Model cost results only pertain to recurring costs. Dr. Ford interjects a "solution" for nonrecurring costs, as well. He collapses the design of nonrecurring TELRIC studies into a basic work time multiplied by wage rate calculation (see Ford Declaration, ¶ 31 note 19). Dr. Ford then dismisses the need for state-specific nonrecurring TELRIC studies, offering instead a variation of his TELRIC Test: "Because the time-to-complete should not vary substantially across states, the TELRIC Test can be performed by replacing the HCPM cost ratio by the ratio of wage rates (as determined from publicly-available or audited sources)." This radical proposal reveals a lack of understanding of the complexity of nonrecurring TELRIC studies, and inexplicably jettisons years of scrutiny and refinement of nonrecurring TELRIC studies. SBC submits that given the two options of Z-Tel's TELRIC Test or SWBT's approved TELRIC studies, it is clearly preferable to rely on the extensive work that state commissions have done.)

[10] *See*, Ford Declaration, ¶¶ 31-35

USF Model costs for end office switching are higher in Kansas than Arkansas. Table 1, contained in ¶ 8 of my Arkansas Affidavit, indicates that the USF Model costs for loop, port, signaling and transport are at least as high, and in most cases much higher in Arkansas than in Kansas. The entire UNE-P proxy cost is 15% higher in Arkansas than in Kansas. The per minute end office usage costs are virtually identical, differing by only one percent between Arkansas and Kansas ($0.001309 for Arkansas compared to $0.001326 for Kansas). Dr. Ford contends that this one percent discrepancy for this single element renders the presumption of TELRIC compliance "somewhat suspect." His "solution" to this minor discrepancy over just this single cost component is to recommend that the FCC "engage in a complete TELRIC Test analysis of this element." This is an extreme response, to say the least, when this insignificant one percent discrepancy is most likely explained by the limitation of the USF Model to achieve absolute precision when attempting very granular cost calculations for specific UNEs in particular states.

9. As I explained in my initial Arkansas affidavit (¶ 8), no CLEC or other party disputed this analysis when it was presented in SWBT's state 271 application in Arkansas. In addition, the Arkansas PSC concluded that:

> "The record clearly reveals that costs in Arkansas are equal to or above Kansas costs (T. 2337, 2391). The proposed UNE rates have also been approved by the FCC as being in compliance with the TELRIC methodology for use in the K2A. In addition, Arkansas and Kansas are geographically similar, have a common provider and similar rate structures. Therefore, the

Commission concludes that the UNE prices in the proposed A2A are within the parameters of the TELRIC methodology as applied."[11]

The Commission should disregard Z-Tel's argument and grant SWBT the presumption of TELRIC compliance for its Arkansas rates based on my analysis that Arkansas recurring costs are at least as high or higher than those in Kansas.

10. In sum, Z-Tel's use of the USF Model is entirely faulty. Z-Tel's proposal clearly biases the outcome, ensuring that the UNE rates in question appear not to be based on legitimate cost differences between the states.

<u>Z-Tel's, AT&T's and WorldCom's Misuse of USF Model Results Produce Unreliable and Inappropriate Costs</u>

11. Notwithstanding the foregoing analysis that establishes that the FCC and respective state Commissions should be relied on when evaluating Missouri's and Arkansas' UNE rates, Z-Tel, AT&T and WorldCom all misconstrue the import of cost results from the USF Model to claim that Missouri and Arkansas UNE rates are too high. These CLECs continue to misuse the USF Model as an overall means of attacking UNE prices, even when complete and approved TELRIC studies support those prices. This tactic is faulty for at least two reasons. (1) It extends application of the USF Model well beyond its design and intended purpose, as described by the FCC; and (2) it diverts attention away from an analysis of whether or not a state has committed "clear error" in this application of this Commission's TELRIC rules.

[11] Second Consultation Report of the Arkansas Public Service Commission to the Federal Communications Commission Pursuant to 47 USC Section 271 (d)(2)(B), In the Matter of the Application of Southwestern Bell Telephone Company for Authorization To Provide In-Region InterLATA Services, Docket No. 00-211-U (rel. 5/21/01), at 8.

12. Notable are AT&T's and Z-Tel's disparate starting points for the USF Model cost results upon which they rely. This disparity illustrates the futility of trying to use USF Model cost results for a purpose they were not designed to serve. Both AT&T and Z-Tel acknowledge that certain adjustments must be made to USF Model cost results in order for the model to be arguably relevant as a benchmark for judging UNE rates. Both AT&T and Z-Tel describe adjustments aimed at correcting similar deficiencies in the USF Model results (*see* Lieberman Declaration (AT&T), ¶ 21, note 10; Ford Declaration (Z-Tel), ¶ 15). Table 1 below illustrates AT&T's and Z-Tel's adjustments made to USF Model loop costs.

TABLE 1

State	**AT&T's Adjusted USF Model Loop cost**[12]	**Z-Tel's Adjusted USF Model Loop cost**[13]
Arkansas	$18.96	$19.06
Kansas	$15.17	$18.52
Missouri	$15.28	$22.72
Oklahoma	$16.63	$20.30
Texas	$12.82	$16.39

13. Obviously, these parties use very divergent adjusted costs as a starting point for basing a comparison to UNE rates. AT&T and Z-Tel are not even close to agreeing on a reasonable *starting point* for USF Model cost comparisons. Yet, without a firm starting point, there is no

[12] *See* Lieberman Declaration, Exhibit 11

[13] *See* Ford Declaration, Table 1, p. 7.

way that subsequent cost-to-rate comparisons can be considered legitimate. This basic cost disparity illustrates the futility of trying to force fit an application of the USF Model for a task it was not designed to accomplish. Consequently, UNE price reductions, seeking to match percentage differences in the these adjusted costs between states, does not bear any relationship to SWBT's true underlying actual, forward-looking costs.

14. AT&T's, Z-Tel's and WorldCom's[14] attempt to use USF Model cost results to derive new UNE rates for Missouri and Arkansas is fraught with further peril. The FCC has recognized that the USF Model should not be relied on to set rates for UNEs. In fact, in its Massachusetts Order, the FCC stated, "[t]he Commission has never used the USF cost model to determine rates for a particular element, nor was it designed to perform such a task. The model was designed to determine relative cost differences among different states, not actual costs."[15]

15. A primary reason the USF Model cannot determine appropriate UNE prices or actual costs is because it relies on default, nationwide-average inputs related to investments (i.e., network equipment), capital costs (e.g., depreciation, and cost of capital) and operations expenses (specifically, maintenance expense). These nationwide inputs cannot capture study-area specific network characteristics that are critical cost distinctions embodied in only SWBT's TELRIC studies. For example, the USF Model default nationwide inputs affecting loop costs include: cable fill factors for feeder and distribution, structure costs including trenching labor, plant mix values, Service Area Interface (SAI) splicing and labor rates, and Digital Loop Carrier (DLC)

[14] *See* WorldCom Brief, p. 20, notes 29 and 30, and the Declaration of Chris Frentrup, ¶¶ 3, 7-10.

[15] Massachusetts Order, at ¶ 32. This position is echoed in the Kansas/Oklahoma Order, at ¶ 84.

contract data.[16] Each of these inputs can vary significantly from state to state and from company to company. Each of these variables drives unbundled loop costs. Applying nationwide values for these investment inputs, as the USF Model does, glosses over state and company-specific variables that can significantly impact the underlying TELRICs for loops.

16. Even more influential than the investment drivers on resulting costs are capital costs and operations expenses. The USF Model employs default nationwide values for depreciation and cost of capital,[17] as well as for plant-specific operational maintenance expense.[18] The default values for capital costs and operations expenses markedly diverge from SWBT's state-specific values and, when applied in the USF Model, produce cost results that systematically understate SWBT's TELRICs. (*See also* Reply Affidavit of Barbara Smith, ¶¶ 92-99). The FCC, recognizing the influence that these nationwide inputs have on costs, has cautioned the validity of applying USF Model cost results outside of the context of universal service. Specifically, the FCC has concluded:

> For universal service purposes, we find that using nationwide averages is appropriate. The Commission has not considered what type of input values, company-specific or nationwide, nor what specific input values, would be appropriate for any other purposes. The federal cost model was developed for the purpose of determining federal universal service support, and it may not be appropriate to use nationwide values for other purposes, such as determining prices for unbundled network elements. We caution parties from making any claims in other proceedings based upon the input values we adopt in this Order.[19]

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[16] Tenth Report and Order, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 95-45, released 11/2/99, ("Tenth Report and Order'), at ¶¶ 186, 209, 218, 219, 233, 239, 253, 255, 258, 262, 274.

[17] *Id.* at ¶¶ 422-432.

[18] *Id.* at ¶¶ 341-342.

[19] *Id.* at ¶ 32. This same point also appears in the FCC's Ninth Report and Order, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, released 11/2/99 ("Ninth Report and Order"), at ¶ 41.

17. AT&T's, WorldCom's and Z-Tel's suggestion that SWBT's switching rates be reduced to reflect USF Model results for switching cost elements illustrates the aforementioned methodological problems. The USF Model costs for specific switching-related UNEs also reflect nationwide investment, capital cost and operations expense inputs that do not reflect company or state-specific cost distinctions. For switching, the USF Model relies on publicly available data on the cost of purchasing and installing switches, rather than on company-specific and proprietary contracts.[20] A key driver of SWBT's switching costs are the prices it pays its switch vendors for purchasing and installing switches and lines. The USF Model does not reflect this vital cost information that dictates the forward-looking switching costs SWBT will incur. Only SWBT's TELRIC studies for switching elements reflect this contract-specific cost information. Another influential nationwide investment input related to actual switching cost in the USF Model is the switch capacity constraint.[21] The USF Model uses a default value for switch capacity that often varies substantially from the actual, forward-looking switch capacity experienced in a particular state. A default nationwide value also applies for switch port administrative fill.[22] Switch fill factors are a major determinant of resulting unbundled switching element costs. To apply a nationwide value for switch capacity use rather than state and company-specific data will result in cost results for unbundled local switching, unbundled tandem switching, and unbundled switch ports, which vary from SWBT's actual forward-looking TELRICs. Other default USF Model investment inputs include standard switch purchasing based on line size, MDF/Protector per line investments, and uniform costs for connecting remote switches to the host. For each of these inputs, SWBT's TELRIC studies reflect specific values

[20] Tenth Report and Order, at ¶ 290.

[21] *Id.* at ¶ 328.

[22] *Id.* at ¶ 330.

reflecting contract arrangements. As with loops, the USF Model switching costs reflect nationwide default values for capital costs and operations expenses that diverge from SWBT state and/or company values. Because capital cost and operations expense inputs greatly influence the level of costs, applying values that do not represent SWBT's true capital costs and maintenance expenses (as is the case with the USF Model) produces cost results that significantly diverge from SWBT's actual, forward-looking costs.

18. SWBT's TELRIC studies reflect those forward-looking costs the company actually expects to incur in provisioning switching UNEs in SBC's respective state jurisdictions, and not the averaged cost results produced by the federal USF Model. The costs the company actually expects to incur, with a forward-looking network deploying efficient technologies, must underlie UNE prices. The best indicator of SWBT's actual forward-looking costs is its own cost studies. SWBT's approved TELRIC studies, coupled with SWBT's focused USF Model cost comparison applied only between Arkansas and Kansas, are the only sanctioned devices the Commission should use as it determines if SWBT's Missouri and Arkansas UNE prices comply with TELRIC principles.

19. Testing for compliance with TELRIC relying solely on state cost differences derived from the USF Model is too simple of a test and may fail to account for real variations in costs among states.

Conclusion

20. TELRIC-based cost studies are the only prescribed indicator of SWBT's forward-looking costs upon which UNE prices can be set. SWBT's Missouri and Arkansas UNE prices are entirely compliant with TELRIC principles. Missouri UNE prices were set after extensive reviews and proceedings conducted by the MPSC. Arkansas UNE prices are similarly TELRIC compliant, since they mirror Kansas rates that underwent intensive scrutiny and approval by the Kansas Commission and the FCC. Any application of the USF Model must be strictly limited to a comparison of the relative differences in costs results among states. The cost and rate comparisons provided by AT&T, Z-Tel and WorldCom violate the proper and limited use of the USF Model.

This concludes my affidavit.

I state under penalty of perjury that the foregoing is true and correct.
Executed on

Thomas J. Makarewicz

Thomas Makarewicz

STATE OF MISSOURI)
COUNTY OF JEFFERSON)

CYNTHIA J. HOUSLEY
Notary Public – Notary Seal
State of Missouri
County of Jefferson
My Commission Expires Feb 21, 2005

Subscribed and sworn to before me on this 28 day of September 2001.

Cynthia J Housley
Notary Public